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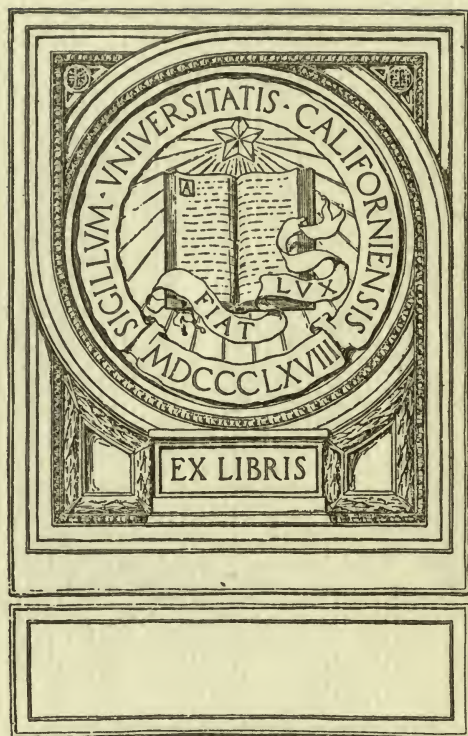
Financing the War

A. Barton Hepburn

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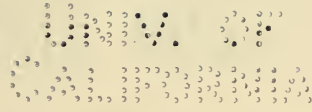
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Financing the War

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by

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A Lecture

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on the Spencer Trask Foundation

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FINANCING THE WAR

The subject assigned me is so comprehensive that I hardly know the best avenue of approach. It seemed to me that it would be agreeable to you, as students, to have recalled the principles that should govern, in financing a great war, followed by a practical, though very general, application to present conditions. The Government defends us from foreign enemies, domestic sedition, the infringement of personal and property rights, provides instrumentalities for the determination and enforcement of our rights through courts and constabulary and military and naval force if need be. Every law has an unseen bayonet behind it to secure its enforcement. In order that the Government may have the means of accomplishing all this it reaches down into our pockets and takes what funds it may require in the form of taxation; it reaches into the family circle and takes, by voluntary action or conscription, what man-power it may need. The state is the collective individual, the combined power, energy, brain, heart, conscience that results from each individual yielding his support and loyalty to the whole. Thus the individual, protected by the whole, has the right to life, liberty and pursuit of happiness, with the limitation that he must not infringe the similar right possessed by others. We are apt to regard the Government as a benefactor and clamor for whatever assistance we fancy we need, forgetting that whatever the Government gives to one it must first take from others. Now in the presence of this grave conflict, it is the Government that needs, sorely needs support and our loyalty and

patriotism are subject to a trying ordeal, bravely and joyfully borne, however.

The first response is from the man-power of the country. Our patriotic young men, in the morning of life, selected because of their personal prowess and patriotic devotion, going to the front to find perhaps a soldier's grave or a sailor's rest in the grim old ocean or to return broken and maimed to carry the red badge of sacrifice throughout their remaining years. This typifies the highest level of patriotism, the highest plane of devotion to one's country. The country calls upon the treasures of youth—which are strength, courage, brain and brawn—and calls upon the equally important treasures of thrift, the accumulation of labor and adventure. We are to consider the less heroic but none the less important financial aspect of the war.

Money; How Raised in the Past

Money is the medium of exchange that supplies the Government's material needs. How shall it be raised? Perhaps a glimpse at the past may be helpful. In 1714 the national debt of all civilized nations totaled \$1,500,000,000. A little more than a century later, in 1820, it was \$7,750,000,000. The Napoleonic wars, our Civil War, and other wars rapidly increased the amount until in 1882 it approximated \$27,000,000,000. H. C. Adams in 1887 wrote, "The civilized governments of the present day are straining under a burden of \$27,000,000,000. This sum, which does not include local indebtedness of any sort, constitutes a mortgage of \$722 for each square mile over which the burdened governments extend their jurisdiction . . ." In earlier years sovereigns felt it their duty to provide a war chest for emer-

gency use in self-defense and quite as often, perhaps, to enable them to strike at the psychological moment in some aggressive campaign. They raised funds by plundering enemies, confiscating property of enemies or rivals and by levies upon individuals, and forced loans. There was no general taxation systematically levied. With the increase of wealth, with the disappearance of the nomadic tendencies of people, which naturally resulted from the growing stability of government and the protection of property and its enjoyment, the means of raising money for the support of governments became more refined. Precautionary funds were no longer secured in advance and by a system of borrowing and funding, present payment for war expenditure was postponed and the burden transferred to the future.

Growing Government Debt

A study of the income and disbursement accounts of the nations and their constantly growing debts shows that they have been capitalizing current expenses. They have not paid their way. They have been borrowing money to live upon. I am speaking of the ordinary cost of government and not including extraordinary expense as, for instance, financing a war. This is true of national governments and, as to municipal governments, the debt increase is appalling. The debt of France was reduced very little from the time of the Franco-Prussian War, 1870, to the beginning of the present war, 1914. The debt of England remained about stationary for a generation prior to the Boer War and, of course, was increased as a result of that war. Our own government is an exception to the general rule. Our government has been conducted upon the principle of having a surplus

of income over expenditure and debt reduction is the general policy (although the war with Spain and the construction of the Panama Canal and other causes have interfered with the policy in recent years).

Credit

It is a common saying that you can have nothing in the line of credit better than the credit of the government under which you live. Hence, government obligations have ranked high, and the ease with which loans could be floated has been too tempting for politicians to withstand. To confront the electorate with severe taxes might involve political disaster; to borrow and devolve payment upon posterity lost no votes. This, I think, largely accounts for the tremendous increase in national as well as municipal debts. However, the world is growing richer and the public demands increased indulgence. We have reached a point, since this war began, in some nations, where private and corporate credit are better than that of the government.

Expense That May Properly be Raised by Bond Sales

There are economists who maintain that all government expenses should be met by current taxes, that it is wrong to mortgage the future and impose bond burdens upon posterity. This doctrine literally applied would strangle any government overtaken by emergency. Taxation is a slow process of realizing money. We pay taxes once a year, except as to internal revenue taxes, represented by stamps, which are paid at the time of each transaction, and customs taxes which follow each importation. Posterity enjoys the liberty won in our War for Independence and was justly asked to bear

a portion of the expense. There are wars for a principle like the present war which may be succinctly characterized as Democracy vs. Autocracy. Future generations are surely interested in the result. The Panama Canal will be used by posterity and should in part be paid for by posterity. Where a government, municipal or otherwise, builds a road, bonds issued to raise funds for the work should not run longer than the road will last. The people who use the road should pay for it; by the same principle the people who are interested in a war fought for principle may be required to bear in part its expense by the flotation of bonds for posterity to pay. The people who endure the hardships, the pains, the loss of life may well pass on to the future some of the financial burdens.

For two and one half years our Government watched the conflict without any move toward preparedness, hoping the storm would pass us by. Then they undertook under great pressure to increase and equip the Army and Navy and provide what material things they and their Allies needed to win the war. Manifestly, taxation and credit should both be asked to supply such importunate demands, but in what proportion? The discussion of this question by Congress delayed legislation for many months. The expense of the war must be paid from the savings of the people; hence the importance of knowing the amount of such savings. The ability of people to pay taxes or to lend money to the government rests upon the same source; it depends upon industrial activity and prosperity. Taxation that would discourage business, either in the manner of its imposition or the amount, would defeat its own ends, would fail to fill the Treasury; it would also impair the power of the public to subscribe for bonds.

What is the Increment of the Nation?

The resource, then, from which the Government must realize its needs is the net increment of the people, the balance left over after the expense of living is taken from the net profits of business—the increment. It becomes important, and should be the first solicitude of the Government, to inquire what may be the amount available for new investment. The Government sought to go to the limit in the amount of taxation imposed, stopping just short of impairing business prosperity. In this purpose I think they were right; but just what the practical working of their two revenue laws may be remains to be seen.

The ease with which a government can place loans and the rates of interest they will have to pay depends upon the government's credit. Nothing improves government credit more than to inaugurate good stiff taxation to supplement loans. Such taxation has a buoyant effect upon credit; it strengthens a bond issue in the same general way that a sinking fund does, for it evidences strongly the government's purpose to pay.

Past Experience

We have before us the experience in financing the War of 1812 and also the Civil War of 1861. In both instances the bond issues suffered in the popular price they commanded by the failure to raise sufficient funds by coincident taxation. Had good, wholesome effective measures of taxation been employed in 1861 the amount of Treasury notes required would have been lessened and the alleged necessity for making such notes (greenbacks) legal tender would not have arisen. During the Civil War bonds were issued the proceeds of which were

\$2,565,000,000. The bonds were paid for at par in Treasury notes, but these notes were at a discount. Figured on a gold basis the Government realized for such loans only \$1,705,000,000, a shrinkage of \$860,000,000, nearly $33 \frac{1}{3}$ per cent. All our government bonds, by process of refunding or otherwise, have been paid in gold or its equivalent and the faith of the Government is pledged to pay all of its bonds, principal and interest, in gold. Vigorous taxation might have saved the Government that \$860,000,000 but in the early sixties there was great division of sentiment and political expediency doubtless had much influence. In the present war our Government has avoided the mistakes of 1812 and 1861. May they not have gone too far in the opposite direction and have imposed too drastic taxation?

Income tax returns are as yet incomplete and we lack authentic data from which to estimate the increment of the nation. In England the income tax returns are very complete and economists estimate her increment prior to the present war, that is, the annual amount of money available for new enterprise, additional investment, at approximately \$2,000,000,000. The Chancellor of the Exchequer stated in Parliament, in the early stages of the war, that the United States was indebted to England in the sum of \$5,000,000,000 and to the continent of Europe to the amount of \$1,000,000,000. Again, the British income tax gave data as to the amount of English investments in America or, in other words, our indebtedness to England, which enabled the Chancellor, having access to this data, to make a very close estimate. All the world owed England. She had 54 per cent of the carrying trade of the ocean; her insurance companies

are the largest underwriters the world over; 44 per cent of the fire underwriting in this country was done by foreign companies. As the Clearing House of commerce and the Banker of the world she drew tribute and interest from all quarters. The United States was a debtor nation and, as we have seen, was paying interest on an estimated \$6,000,000,000 to Europe. England is an old country and has comparatively few latent resources. On the other hand, the latent resources of the United States were constantly being developed and by so doing new wealth, not theretofore existing, was constantly coming into use.

Sir George Paish, one of the Editors of the London Statist, a British Treasury official and one of the world's leading economists, was of the opinion that, all things considered, the net incomes of the United States and England were just about equal in amount. Sir George Paish estimated the net increment of the United States at the beginning of the war at \$2,000,000,000 annually. The enormous trade balances in our favor, for these three years of war, have enabled us to become a creditor nation by buying back our obligations owned abroad, to a very large extent, and by offsetting the balance by making loans abroad. The insistent demand for food, clothing, war material at constantly advancing prices gave our people large profits, tilted the international trade balance largely in our favor and increased the net income of the nation. War profits were large, very large and in some instances are still large. A steel company which takes its ore from the ground and sells steel at \$60 per ton and the finished steel products made therefrom, at corresponding prices, must realize large profits. A copper company that produces copper, at approximate-

ly normal cost, and sells the same at prices now prevailing must realize very large profits. On the other hand, any corporation that buys steel at \$60 per ton, copper at 28 cents per pound and produces goods therefrom, must, especially in view of the largely increased cost of labor, figure very closely to be sure of any profit.

Our Agricultural Department estimates the value of our cereal crop for the past year at \$21,000,000,000 as against \$13,448,310,509 for 1916. A phenomenal increase truly, but do not adopt the popular idea that that large increase is added to our purchasing power. We export about 150,000,000 bushels of wheat which, paid for by foreigners at \$2.20 a bushel, adds to our international trade balance \$180,000,000 more than it would, at \$1 per bushel, which is about the normal price. Our current income, our investment increment is increased by this additional sum realized from the foreigner. All the wheat crop consumed at home is paid for by our own people, at \$2.20 per bushel, and their income is taxed very heavily thereby. The farmer, again the producer of raw material, prospers wonderfully, but the consumer's burden is increased in the same proportion. The increased price involves a readjustment among our own people as to the amount consumed at home and does not increase the purchasing power of our people, as a whole, one penny.

I have in mind a corporation that, in 1914, made a contract with a European government for the manufacture of a very large number of military rifles. It took nine months to build the necessary buildings, quite some additional time to install dies and machinery. The price of labor, steel, and other articles was all the while rapidly advancing. In short, this corporation lost very

heavily on what looked to be, at the time it was made, a very profitable contract. No one properly gauged the abnormal increase in prices. Another corporation entered into a similar contract for the manufacture of explosives. The advance in the cost of everything forced the company into the hands of a receiver. Representatives of the foreign government called upon the Receiver and asked what he was going to do about the contract. His reply was, "Nothing; the cost far exceeds the prices fixed by the contract." They replied, "We quite understand the situation. Now at what prices can you finish the contract?" They waived the prices fixed and agreed upon an advance giving a fair compensation. They wanted the goods. Another big munition company reached a financial *impasse* and their contracts were transferred to another company on a basis that insured their fulfillment. No one was at fault, except they lacked the prescience to properly forecast the phenomenal increase in the cost of everything. These new arrangements were possible only because the warring nations were so much in need of the goods for which they had contracted. I mention these circumstances to show how far wrong the public impression is that everyone connected with the manufacture of munitions is making phenomenal amounts of money. I mention them also because they have a direct bearing upon a proper estimate of the investment increment of our people as a whole, the increment from which we must pay taxes and buy bonds to enable the Government to carry on the war.

Our Congressmen talk very glibly in billions and are very positive in their views as to what burdens may, with prudence, be levied upon the country's industry. I think

we may aid the Government by helping to reach a proper estimate of the country's savings. The income tax returns will, in future, give a very reliable basis for such an estimate, but an approximately reliable basis is needed now upon which to predicate taxation. I quite agree that current taxes should be as large as industry will bear without discouragement. All business is a venture; there may be varying prospects of success, but sometimes an actual loss ensues. If one takes the chance of a loss the tax gatherer should leave a fair margin of profit in case of success; otherwise, men will hesitate and business be curtailed. This war can not be won unless industry is kept in full volume—volume sufficient at all times to supply the Government with the goods they require. A very large percentage of the business of the country is, at the present time, with or for the Government and that percentage will increase. Large profits made upon advancing prices always have a corresponding loss when the tide turns. When the war ends and prices begin to recede to a normal level much of the profits made on the upturn will be inevitably wiped out and safety requires that fair surplus be accumulated to meet such strain in order to prevent business mortality.

Mr. A. C. Miller was made a member of the Federal Reserve Board at Washington, because, in addition to his many other qualities, he was an economist of standing and repute. In a recent address at Philadelphia he estimated the "surplus income or potential savings of the country for 1917" at from twelve to fifteen billions of dollars. I wrote asking for the data upon which he based his estimate. I quote from his reply:

I am sending you this brief statement:

(1) Estimates made in this office of the total gross income

of the nation show a gross income of thirty-one billions two hundred millions of dollars for the year 1914, and a gross of forty-nine billions and seven hundred millions of dollars for the year 1917—in other words, a growth for the period of the war of over eighteen billions.

(2) My judgment is that the largest part of this increase of eighteen billions is to be treated as an accretion to the money incomes of those classes of the community for whom it is not offset by commensurate increases of living and other costs. To be on the safe side, however, I estimated that a deduction of one-third from the eighteen billions might properly be made to cover increased cost of living, etc., and to account for any variation in the choice of price levels in computing the totals (the larger part of the gain in pecuniary income of the nation from 1915 to 1918 being due to the rapid and general advance in prices). A deduction of one-third or six billions leaves us with an addition to the computed surplus or potential savings fund of the nation of approximately twelve billions.

(3) Estimates of the actual savings fund of the country in 1914 run from three billions to six billions. I have thought it wise to use the former of these figures (though I believe it is far within the mark) in order to offset any excess in the calculation of the proportion of the eighteen billion dollars increase of gross income from 1914 to 1918 to be credited to the surplus income or potential savings fund account. [Note his estimate for \$3,000,000,000 net for 1914.]

The value of my figure of from twelve to fifteen billions as an approximation to the surplus income of the country for the year 1917 depends:

(1) on the validity of my gross figures for 1914 and 1917; and,

(2) on the validity of my inference, or it would perhaps better be called conjecture, as to the proportion of the computed increase in gross income from 1914 to 1918 to be credited to the surplus account,

No one could be more aware of how widely opinions might differ as to the validity of such a process of inference than I, but I felt that unless someone was willing to run the risk of drawing such an inference or making such a conjecture based upon some of the facts, we should be groping and floundering in talking about the financing of the war. I was willing to take the risk in the hope that it would at least serve the purpose of stirring up among bankers, economists and statisticians some more thoroughgoing consideration of this all important question.

I questioned his estimate to which he replied as follows:

You say you can't help but think my estimate of the net income of the country is very, very large. I must admit that the figures startled me when the computation was first made, but I believe they are approximately correct *if too weighty a meaning is not given to the term "net income."* I thoroughly agree with you that the year 1917 is not only exceptional as regards preceding years, but will also be exceptional as regards the year immediately to follow. I would not myself, therefore, wish to draw any inferences as to what we can do in the financing of the war, should it go into a second year, from the figures deduced for our gross money income for the year 1917. I think the figures indicate rather a *plenty* of money, than a *plenty* of the goods and services which the Government will need for the prosecution of the war. Even if it be established, as I think it can be, that there are available for the appropriation of the Government some twelve to fifteen billions of dollars, or say from thirty-five to forty-five per cent of the total gross money income of the nation, it does not follow that the Government can get forty per cent of the physical product of the country or the control of a commensurate amount of the productive capacity—these being the things that count in determining what the Government's economic effective will be in the prosecution of the war.

Mr. Miller is a very able man, his official position gives him a point of vantage in investigating this question and his opinions are entitled to great weight. He thinks his estimate is "approximately correct if too weighty a meaning is not given to the term '*net income*.'" Net income is the balance which a man may use for any purpose that pleases him. It is what is left from one's receipts after deducting all cost, including the cost of living. Now the cost of living may be economical or it may be extravagant and right there is the test of the present situation. In my opinion such a large net income could result only from severe economy. The determination of this question with proximate certainty is vital to the proper financing of the war, and I am carrying out Mr. Miller's hope of "stirring up among bankers, economists and statisticians some more thoroughgoing consideration of this all important question" by putting it up to you. There is a constant educational influence radiating from this great University and I believe the best service Princeton can render is to help our Government to master the economic facts underlying this war and properly gauge the economic influences involved and help to illuminate the relations of industry and capital to the almost superhuman task of financing the needs of the Treasury.

This paper is in the nature of an inquest rather than an argument and I therefore present the views of David Friday, whom I regard as one of our ablest economists. Prof. Friday was many years connected with the University of Michigan, is now connected with New York University and is a member of the firm, Thompson & Black, Financial Accountants and Engineers. He has therefore studied the subject from a practical as well as

scholastic standpoint. Professor Friday's estimate of "Total Excess of Production over Consumption" is as follows for the years 1913, 1916 and 1917:

<i>"Total Excess of Production over Consumption"</i>			
Item	1913	1916	1917
Corporations . . .	1,500,000,000	5,400,000,000	6,500,000,000
Other business enterprises . . .	1,200,000,000	3,000,000,000	3,500,000,000
Farms	1,200,000,000	2,800,000,000	5,000,000,000
All other savings	2,500,000,000	3,500,000,000	3,500,000,000
Total	6,400,000,000	14,700,000,000	18,500,000,000"

Corporations make reports to their stockholders and to the municipalities from which they receive their charters and hence we have reliable data from which to make a very close estimate as to corporations. I quote further from Professor Friday:

An estimate of the volume of liquid savings for investment and for financing the war is set forth in the following table:

<i>Liquid Savings</i>			
<i>Available for Investment and Financing the War</i>			
Item	1913	1916	1917
Corporations . . .	500,000,000	2,000,000,000	3,000,000,000
Other business enterprises . . .	200,000,000	1,500,000,000	2,000,000,000
Farms	100,000,000	1,000,000,000	3,000,000,000
All other savings	2,000,000,000	3,000,000,000	3,000,000,000
Total	2,800,000,000	7,500,000,000	11,000,000,000

In ordinary times the savings of corporations, of other business enterprises and of the farmers are for the most part reinvested in additional working capital and in additional plant and equipment. None of these classes bring to the investment market any considerable volume of liquid funds which can be used for the extension and prosecution of new industrial ventures. The great volume of such investment funds comes from the sav-

ings of individuals. Life insurance alone represented in 1913 approximately \$500,000,000. of individual savings. During 1916 the rapid increase in the volume of working capital—including inventories—of corporations and other business enterprises, was so large as to absorb a large part of the savings of these industries. I estimate that more than 60 per cent of the surplus accumulated by corporations in 1916 was absorbed in additional working capital and necessary additions to plant. Farmers likewise made large extensions to their equipment, such as buildings, fences, and tools and machinery. The great profitability of business in 1916 over previous years increased the income of individuals enormously. Wage and salary increases were common and of generous proportions. The interest and dividend payments of corporations to individuals exceeded those of 1913 by approximately \$1,200,000,000. Without doubt the profits distributed in the form of salaries and distribution of earnings by other business enterprises were much larger than usual. Table V appended hereto shows that the number of income tax returns for incomes of \$150,000 and over was more than three times as large in 1916 as in 1914. Prices, however, had not risen in 1916 sufficiently to absorb this increase in individual incomes. Bradstreet's Index Number for 1915 is only 28 per cent higher than for 1913, and this increase was largely in commodities which do not enter into the cost of living.

I have estimated the liquid savings of individuals at \$1,000,000,000 more in 1916 than in 1913. The amount of liquid savings in the table above for 1916 exceeds the amount for 1913 by \$4,700,000,000. Nearly \$4,000,000,000 of this was invested in the bonds of European governments, in American securities resold here by Europe, and in an addition to our gold supply. The remainder was absorbed by an addition to our usual volume of new securities issued. The amount of new securities as reported by the Journal of Commerce was nearly \$500,000,000 greater than in 1913.

In 1917 the volume of inventories, supplies and goods in process of manufacture has probably not increased over 1916, but the prices of this working capital have risen. There will therefore be, in my opinion, a further absorption of approximately \$3,500,000,000 in additions to working capital and plant extensions. The latter, however, will be much smaller than in 1916. My estimate is that \$3,000,000,000 will be available for excess profits taxes and the purchase of government securities out of corporate surplus. Similar considerations will govern the other business enterprises, and I estimate that there will be available for payment of war taxes and investment \$2,000,000,000. The farmers should have available a largely increased amount of liquid capital, which will not be absorbed in additional plant and equipment if proper inducements are presented to them for investment. Individuals, owing to higher cost of living, have probably not saved any larger quantity of liquid capital than during 1916. We thus arrive at a total of \$11,000,000,000 of liquid savings for 1917. Any sum in addition to this which may be needed for investment and for financing the war will have to be provided by new savings through a decrease in consumption.

Economy always means decrease in consumption. Sufficiently rigid economy will make available such large sums undoubtedly, but they are by no means normal and in all probability will not be sustained in future years and they are not a proper base from which to determine taxation running for a period of years. The producers of raw material have had a most profitable year and that comprehends the farmers. Farmers have in the past been borrowers and they have paid interest upon their loans at rates ranging from 5 per cent to 10 per cent. Now in the Cotton Belt and in other localities they can get interest upon their funds exceeding the rate which government bonds offer. Naturally the farmers

have not thus far been large purchasers of government bonds; neither do they to any great extent contribute to the Treasury under the income tax. Their savings last year are estimated to be 27 per cent of the savings of the whole country. How can their savings be made available for support of the Government in this war?

*Has the Investment Increment of the Nation Increased
Four or Five Fold Since 1914—Increased from
Three to Twelve or Fifteen Billions?*

According to the last Census there was an increase in the value of real estate, 1904-12, of \$48,334,920,444. It is estimated that \$2,000,000,000 per annum is expended for buildings and improvements upon real estate. By the same authority the value of all property other than real estate increased from 1904 to 1912 \$32,300,957,236. The average annual increase was a little more than four billions. Property is cumulative and the savings of one year become capital of the next and serve to still further increase the savings of following years; but bear in mind that advancing prices do not increase purchasing power. A farmer's herd of cattle may double in market price but that does not increase his power to buy bonds, unless he sells the cattle, and selling them would put him out of business. Bear constantly in mind that this increase in wealth is not all money available for investment. With a farmer it might mean more cattle or horses, with a railroad it might mean more rolling stock, with a manufacturer or merchant it might mean more stock on hand, bills or accounts receivable. Our query is as to the amount available for the payment of taxes and investment in government bonds.

Hon. George E. Roberts, Director of the Mint under

two administrations, and now Assistant to the President of the National City Bank of New York, is one of our best statisticians and a well recognized authority. In November, 1916, after a careful review of the subject we are discussing, he wrote, "By the end of 1916 two more years of progress will have elapsed, and the increase of productive wealth in these two years no doubt has been greater than in any other two years in our history. It is safe to say that the net gains of wealth in the United States are now normally not less than \$7,500,000,000 per annum, not including the enhancement of land values, but including the fixed improvements upon land. With the activity prevailing in 1916 the enormous excess of exports over imports, and the very complete employment of our people and our industries, the net gains of this year must be considerably in excess of that amount." Continually bear in mind that this increase in wealth is not all in a form available for investment and in part it represents enhanced values. I also think that the profits for the year 1916 will approximate those for 1917, in all cases except the producers of raw material, for reasons heretofore given, namely, that the cost of materials and labor has overtaken the price of finished products, thus rendering profits more nearly normal. The high cost of living has materially reduced individual savings. Also we have in 1917 taken two million men, for the Army and Navy and for civil employment connected with the war, from the ranks of production and transferred them to the ranks of consumption. That represents a very great economic loss and must lessen the increment of the nation. There is one compensating offset. The place of these men will be taken in part by a class of women who heretofore have

possessed little economic value. In other words, our girls are becoming assets instead of liabilities.

According to competent experts the net annual income of England, at the outbreak of the war, was \$2,000,000,000. Dr. Karl Helfferich, in 1913, estimated the net income of Germany to be slightly over \$2,000,000,000. Recalling Sir George Paish's estimate of the net income of the United States, it would seem that the savings of these three countries were approximately the same. Other estimates of the net income of the United States, by our own economists, ranged up to five billions. This variation shows the lack of reliable data. I canvassed this subject with Sir George Paish and I feel sure that the normal increment of the United States prior to this war was less than \$3,000,000,000. How much has it increased? Profits were unusual, phenomenal in the early part of the war, but now that raw material, labor and finished products are coordinated as to price, what is our net income at present and what may we expect it to be in future?

Fields for Economy

A temperance wave is spreading over the country and this is reinforced by sumptuary legislation. The grain that was used for beer and whiskey must be saved for food. Our temperance friends tell us two and one quarter billions are spent annually for intoxicants. A prolific field for economy, surely. The tobacco crop for 1916 was valued, at the farm, at \$169,008,000. From this was made 417,235,928 pounds of smoking and chewing product, 7,390,183,170 large cigars, many small ones and 21,066,196,672 cigarettes. Legislation has not invaded the field of tobacco consumption except by way

of taxation. A great saving should be reckoned here. Pleasure motor cars, jewelry, clothing, millinery and many other lines could suffer great reduction without interfering with protection and proper comfort. Many things not classed as luxuries should be reduced to the minimum in order to release man-power employed in such industries, not alone for the Army and Navy but for the factory and field, in order that needful things may be produced that will enable us to win this war. From Alexander Hamilton to McAdoo, from the first Secretary of the Treasury down to the time of taking office of the present Secretary, less than \$27,000,000,000 was received into the U. S. Treasury, from all sources, including the financing of the War of 1812, Mexican War, Civil War and Spanish War. Now they propose to raise over nineteen billions the first year and the estimate for the second year exceeds fourteen billions. Can they raise these vast sums? Economy, only, can give an affirmative answer—gruelling economy. The economy of the present will seem extravagance one year from now. As economy increases suffering will increase and as war conditions predominate normal business conditions will have less influence, the basis of industry will become more and more artificial and the success of business will become more precarious. A business man can study the crops, the mines, the factories, the currents of trade, world conditions and can reach a conclusion, based upon his experience of the past, and determine within the limits of conservatism, his line of activities. But war puts everything at hazard and upsets all calculations, tends to restrain business activity and prevent new enterprises. Business has mortality as well as mankind and new activities must continually be born to

compensate for business adventures that, for one cause or another, may cease to exist. In no other way can business be kept at full volume. Every man in business who has reached middle life looks forward to retirement, a period of rest and the pursuit of those avocations which most appeal to him. Aristotle said, "The object of labor is to secure leisure." Men of this age, in troublesome times, are apt to reason that they had better retire with what they already possess rather than continue and put at hazard what they have accumulated for protection of themselves and dependents. It is the proper function of the Government to foster business prosperity, it is also their selfish interest to do so, for then people will cheerfully bear heavy burdens of taxation and patriotically place their surplus funds at the disposal of the Government. The Government with its taxing power must stop short of impairing business, either by discouraging new enterprise or by the imposition of excessive burdens; and this is why the proximate determination of the increment of the nation is so important. To impose taxes greater than can be paid from current earnings would be to compel the reduction of capital in order to pay the tax. It would be in effect a capital tax. It would force borrowing from banks under circumstances which could have no other effect than to impair credit. The borrowing needs of any business enterprise are greatest when the volume of its business is greatest. With growth in volume of business the capital of the enterprise becomes fully employed and must be supplemented by appeals to the banks. The profits of a business determine the amount of income tax to be paid and also the excess profit tax to be paid, as fixed by recent legislation. Now the profit for the year

of any going business is represented only in small part by money as we have seen. It inevitably follows that most large corporations and many individuals will borrow money with which to pay their taxes imposed by recent laws; they will compete with the Government as borrowers in order to pay their tax obligations to the Government.

I repeat that I think as stiff taxation should be imposed as may be without lessening the activities or impairing the ability of people to pay and subscribe. Such taxation will be cheerfully borne. But the Congressional idea and the popular idea that this is a country of unlimited wealth, that we can finance other nations without stint, and spend billions by the score annually and obtain these vast sums, at will, by taxation and by borrowing, is a mischievous idea. People can only buy bonds and pay taxes out of their savings, the money they have left over after paying their current expenses, including the cost of living.

Danger of Inflation

The first income tax and revenue bill produced, in 1916, \$512,702,028.78. The Commissioner of Internal Revenue estimates that it will produce \$750,000,000 in 1917 and that the supplemental bill will increase the amount to \$3,500,000,000. This amount is larger than the increment of the whole nation at the beginning of the war.

There is a limit to what Congress can do with safety and propriety, and it seems to me that the best service we can render is to help find that limit, that the Government may not overstep the same and thereby invite disaster, the disaster of currency inflation and a paper

basis. The Government can raise money without limit by resorting to the printing press. They can make Federal Reserve Bank notes legal tender, borrow from the Federal Reserve Bank and take pay in such legal tender notes. That is practically what some countries in Europe have done. That would put us on a paper basis, produce inflation of currency, depreciation of values and all the train of concomitant evils. The great danger that confronts us is that we fall into the same financial welter that obtains in some European countries, that we will lose the proud preeminence of being squarely on a gold basis, with the prestige that it will give us after the war and the impetus that it will give to our international trade after the war. Dollar exchange, with the dollar on a paper basis, will make little headway in displacing the pound sterling, and the recent enormous growth in our financial and commercial relations with the world may fade away.

Germany's Experience

Germany had the best ordered banking system of any country at the beginning of the war. She had land banks, mortgage banks, industrial banks, and a splendid system of commercial banks. She was prepared for the war. The next day after war was declared she opened a new class of loan banks—Darlehenskassen—about 1800 in number, one in every place where the Reichsbank had a branch. They were authorized to make loans on non-perishable personal property. They were started without capital, in lieu of which they were authorized to issue a currency called Darlehenskassen Schein in payment of such loans. These notes were made exchangeable for notes of the Reichsbank which

latter are legal tender. The Reichsbank had for years been required to maintain a gold and silver reserve against outstanding circulating notes equal to thirty-three and one-third per cent. The law was changed and the Reichsbank was allowed to consider these Darlehenskassen Schein as gold cover—some as gold reserve. That means that against 100 marks of this currency the Reichsbank could issue 300 marks of its own notes. The flood gates were opened wide. Up to date Germany has realized 73,000,000,000 marks from bond sales, according to a recent statement of her Chancellor. And the Reichstag has just authorized another bond issue of 15,000,000,000 marks. Her borrowings in the form of Treasury notes and other circulating mediums amount to 20,000,000,000 marks. In the early period of the war, in order to emphasize Germany's financial power and great resources, her Chancellor stated that Germany could, if the need arose in order to win the war, raise sixty billion marks. She has already far exceeded that amount. There are many things the Germans do worthy to be copied and many that are not worthy. Let us strive not to copy their financial experience in the present war. Our loans to Allies and expenditures should stop short of impairing our credit as a nation. The Government fixed the price of coal, in order to prevent extortion, and they acted unwisely, naming prices that limited production at a time when the whole world is suffering for coal. The practical working of the schedule showed their error and they amended their action; but at what a cost! Worldwide transportation is indispensable to win this war. The Government's treatment has been such for 25 years as to impair the confidence of wouldbe investors in railroad securities,

with resulting difficulty in financing the indispensable needs of the roads and the equally indispensable needs of the public. Our Government has forbidden a division of territory by the railroads, has forbidden pooling of freight or pooling of earnings, has forbidden traffic agreements, manifestly in the interest of the shipper and the public, for fear that a monopoly would be created; compelled parallel lines to maintain an almost hostile attitude to escape Governmental suspicion; all must compete, lest they conspire and agree—competition, enforced competition was the only panacea. The Interstate Commerce Commission doggedly refused increase in freight rates to railroads notwithstanding the manifest increase in cost of management. Large increases in the wages paid their employees and the wages paid to coal miners, which added directly to the cost of coal consumed by their locomotives, found favor with the Government, but a corresponding increase in the charge the railways make to the public for service found no favor. A crisis in railway affairs logically arose. Now the Government has taken over the roads and flung to the winds the principles underlying the Sherman Law, the law creating and defining the power of the Interstate Commerce Commission, and all laws by which they have for the past twenty-five years sought to regulate the railroads. The Government has, in this crisis, proceeded to do what railway managers were forbidden to do and for the doing of which the Government has held prison doors ajar for two decades. The tuition is high but we are learning valuable lessons from our experience in this war. To you, as students, this marked change in the attitude of our Government is worthy of present note and future study. The Government now

fully realizes that the business activities of the country as a whole must have proper treatment in order to mobilize the great power of the nation and give to its action homogeneity, harmony and efficiency in this great crisis. Our Government is striving hard and doing its very best to accomplish what we all so much desire, win this war, and all comment and criticism should be kindly, not captious, designed to help not to hinder. Shoulder to shoulder we must give the government every support that economy and patriotism can furnish.

What of the Future

One is tempted to speculate as to conditions after the war. How can these nations so overwhelmed in debt bear up under the interest charges, let alone payment of the principal? Just before the war Germany imposed a capital tax in order to create a war chest. A capital tax means a certain per cent levied upon all capital, the wealth of the nation. For instance, a 10 per cent capital tax levied upon the wealth of the nation, payable in government securities to be cancelled, would scale down the funded debt very largely. Portugal, in financial need, imposed a tax upon her outstanding bonds which in effect reduced the interest which the holders received to 1 per cent, and later, when her financial budget was more favorable, changed the tax so that her bond owners realized $1\frac{1}{2}$ per cent. Repudiation is vulgar and leaves a taint; by indirection the same result may be in part accomplished. Given fixed conditions one might, in the light of experience, figure out a reasonable conclusion as to the future. Conditions are not fixed and the financial condition of the warring nations is one hundred millions worse today than yesterday and they will be one hun-

dred millions more involved tomorrow than today, and the end of the war is not in sight. Why speculate? One thing is certain that following the war Doctor Demagogue will be in evidence and will have abundant nostrums ranging from sugar-coated speciousness to rank repudiation.

Adam Smith, in his *Wealth of Nations*, revised in 1776, at which time the total debt of all civilized nations was about two and one half billions of dollars, uses this language: "The progress of the enormous debts which at present oppress, and in the long run will probably ruin, all the Great Nations of Europe has been pretty uniform." Shades of Adam Smith, if cognizant of affairs of the world in which you once lived, kindly cast the world's horoscope and tell us what of the future!

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